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# QUARTERLY ECONOMIC COMMENTARY

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# OUTLOOK AND APPRAISAL

**Despite the decline in UK gross domestic product in the first quarter, there are (at last) some signs of economic recovery. We maintain the view, however, that recovery will be slow and will not resume in earnest until next year.**

Since last December our model of quarterly movements in the seasonally-adjusted Scottish index of production has been forecasting that an apparent upturn in the third quarter of 1991 would be followed by a decline in the final quarter before the resumption of modest output growth. The latest provisional estimates from the Scottish Office suggest that this was indeed the case, with the total index of production and construction falling in the three months to December by 0.3%, compared with a UK fall of 0.5%. In manufacturing the decline was significantly greater; 1.1% for the quarter in Scotland compared with 1.4% in the UK as a whole. On an annual basis the index of production still provides evidence that the recession has been less severe in Scotland than in the UK. During the calendar year 1991 Scottish manufacturing output is provisionally estimated to have declined by 4.5% while that of the UK fell by 5.2%. The relative difference between Scottish and UK industrial performance is even greater when the broader overall index of production and construction is considered (excluding oil and gas production). Here the annual decline in the Scottish index was 2.8%, while the UK index fell by 4.7%.

Although one should always be cautious of drawing attention to a single quarter's figures, there is one potentially encouraging sign in the latest index of production data. The production of investment goods, on which Scotland is relatively more heavily dependent than the UK as a whole, declined dramatically during the second half of 1990 and into 1991. However, investment goods output in Scotland is now estimated to have risen for two successive quarters, at a time when the corresponding output in the UK is still in falling. This is very welcome at a time when manufacturing investment is still in decline - capital expenditure by UK manufacturing industry fell again in the first quarter of 1992 to a total 11% below that of the corresponding period last year, the eighth successive quarterly decline.

### The UK economy

Much of the recent data on the UK economy appears fairly negative at first sight. Gross domestic product is estimated to have declined by 0.6% in the first quarter, the seventh successive decline in non-oil quarterly GDP. The balance of outstanding consumer credit continued to fall in the three months to March, indicating that consumers are still keen to reduce the debt overhang which was discussed in some detail in the last Commentary. And, as indicated above, investment expenditure continues to fall.

Yet within these figures there are hints at renewed confidence and the beginnings of upturn. Manufacturing output rose slightly in the first quarter after six quarters of decline, with a slight upturn in the output of consumer goods which may indicate an anticipated upturn in consumer demand (see British Economy section). Seasonally-adjusted retail sales rose by 0.8% in April following a decline in March, although the total volume of retail sales in the quarter to April still fell by 0.3%. Finally, stockbuilding continued to decline at an decreasing rate in the final quarter of last year, and the upturn in the output of consumer goods in the first three months of this year suggests that stockbuilding may soon begin to grow again.

These are all encouraging signs, and while hopes have been dashed before, may at last point to the beginning of the end for a very persistent recession. As always, however, there is a fly in the ointment. Over the past thirty years sustained economic growth in Britain has continually been thwarted by balance of payments crises which resulted in the economic policies which produced the 'stop-go' cycles. One of the worrying features of the present situation is that the merest hint of an end to recession, let alone significant growth, has been accompanied by a marked deterioration in the UK's balance of payments position. The visible trade deficit rose from £891 million in March to £1.36 billion in April, the highest monthly deficit since mid-1990, mainly as a result of a rapid rise in imports. There is, of course, need for caution in dealing with a single month's figures, and an optimist may see a surge in imports as evidence of economic recovery; but it is possible that the tendency to suck in imports so quickly at the very earliest stages of recovery could be a reflection of the industrial capacity which has been lost to the British economy during two severe recessions in a little over a decade. If so, this may be a long-term problem.

**Prognosis**

In addition to the production figures reviewed above, other recent data on the performance of the Scottish economy indicate considerable resilience in the face of recession. As has been the case for the last eighteen months, the labour market provides the clearest evidence of this.

In early 1990 the seasonally-adjusted rate of unemployment in Scotland was over one-and-a-half times that of its UK counterpart, but has now fallen fractionally below that of the UK for the first time. This series of data has recently been revised (see Regional Review section), giving a clearer indication of the way in which the recession travelled north. Unemployment began to rise in the South of England in February 1990, the rise in unemployment reached the Midlands in April, the North of England in July, and did not reach Scotland until October of that year. Since that time the rise in Scotland's unemployment rate has been consistently below that of Britain as a whole. Vacancy levels are also running at healthier levels in Scotland. Scottish vacancies in April were 86% of the level recorded in January 1990, compared with 59% for Britain and 51% for the South of England against the same base period. In addition, unfilled vacancies in Scotland have risen for four months in a row, slightly better than the position in England.

Much stress has been laid on the need for consumer confidence and hence expenditure to pick up in order to fuel recovery, and what evidence there is suggests that Scotland still fares relatively well in this regard. Direct data on retail spending in Scotland are not available, and so we must resort to more indirect methods, such as an examination of the value of assets on which wealth is based. The argument here is that people feel wealthier when major asset prices are buoyant, and so expenditure from current income is likely to be higher. The most significant of these assets is of course housing, and the latest figures from the Building Societies Association indicate an overall rise in house prices in Scotland of 9% in 1991, in marked contrast to the 1.5% fall recorded in the UK as a whole. Coupled with the lower level of debt outlined in the last Commentary and the less rapid increase in unemployment discussed earlier, this should indicate more buoyant consumer expenditure in Scotland than in the southern part of Britain.

What little information there is on Scottish retail sales appears to support this view. The Scottish Chambers' Business Survey indicated a net balance of 7% of retail respondents experiencing increased sales the first quarter, following a zero balance in the previous quarter. In addition, a balance of 18% of retailers indicated that they expected sales to increase in the second quarter. The overall impression from the last SCBS was of modest increases in optimism and sales/orders in most sectors, albeit with a significant degree of caution about the future.

And the future is, of course, highly dependent on the outlook for the UK. Falling interest rates, a decrease in the rate of increase in unemployment, and the first signs of movement in the housing sector all suggest that consumer expenditure should revive in the next six months, and with it GDP growth. The external position is slightly more uncertain, however. Both the UK and Scotland depend heavily on foreign trade, and in addition to Britain's incipient balance of payments constraint the economies of the major industrialised countries are showing mixed evidence of recovery. The United States is at last showing some signs of an end to recession, but both Germany and Japan have pressing economic problems (see World Economy section). Nevertheless, on balance the economic indicators favour a return to economic growth in the second half of the year.

This is reflected in the latest projections from the Institute's short-term model of the seasonally-adjusted Scottish output index for production industries. The model now forecasts a rise of 0.8% in the index of production during 1992, a substantial upward revision from last quarter's projection. This is in part due to a sizeable upward revision by the Scottish Office of the index of production for the third quarter of 1991, but also reflects the slightly more optimistic outlook for the UK. It remains the case that output is forecast to grow more strongly in the second half of the year than in the first.
4 June 1992